Statement before the United States House of Representatives
Committee on Ways and Means
Subcommittee on Select Revenue Measures

For a Hearing on

"Private Employer Defined Benefit Pension Plans"

on

September 17, 2014

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Thank you Chairman Tiberi, Ranking Member Neal, and Members of the Committee for the opportunity to testify today. I am Diane Oakley, executive director of the National Institute on Retirement Security (NIRS). NIRS is a non-profit, non-partisan research and education organization committed to fostering a deep understanding of the value of retirement security to employees, employers and the economy. Defined Benefit (DB) pensions, the focus of today's hearing, enable Americans to be self-sufficient in retirement, provide an important workforce management tool for businesses, and support the U.S. economy.

Forty years ago this month, major consumer protection legislation impacting pension plans, the Employee Retirement Income Security Act of 1974 (ERISA), became law. Congress acted then to protect Americans' pensions and financial security. As we look to the future, Congress will continue to play a critical role in ensuring pensions remain an important tool for private sector businesses and Americans at a time when retirement readiness is in decline.

The first private sector defined benefit pension plan was created in 1875 by the American Express Company. Over pension's first century, numerous private sector employers have followed suit by offering DB pensions to their employees because pension are valued by employees and employers alike. Employees value that pensions provide a predictable income that lasts after a lifetime of work. Employers value that pensions provide companies with a powerful human resource tool for recruitment retention, and workforce management while offering cost effective retirement security.[1]

As we reflect on ERISA, the title of this 1974 law had the right focus: **retirement income security**. In fact, one of our nation's Nobel Prize winning economists wrote in a recent issue of the Harvard Business Review summing up the key issue working American families face in regard to retirement security. Robert C. Merton said that the primary concern of the saver remains the question "Will I have sufficient income in retirement to live comfortably?" He asserts, "the relevant risk is retirement income uncertainty."[2]

Americans are very worried about their retirement financial security. In *Pensions & Retirement Security 2013: A Roadmap for Policymakers*, NIRS found that Americans are very uncertain and worried about their retirement outlook despite recovery of the financial markets, declining unemployment and increased consumer confidence. An overwhelming majority of Americans (85 percent) report concern about their retirement prospects, with more than half (55 percent) very concerned.[3] This concern is well founded. Recently, the Federal Reserve Board, in its "Report on the Economic Well-Being of U.S. Households in 2013," found that "many households reported that they are not ready for retirement," with almost half of respondents

[1] I. Boivie and C. Weller, 2012, "How DB plans influence labor relations in the wake of the Great Recession," in D.J.B. Mitchell, Ed., *Public Jobs and Political Agendas: The Public Sector in an Era of Economic Stress,* Labor and Employment Relations Association Research Volume, Cornell University Press, Ithaca, NY: B. Almeida and W. Fornia, 2008, "A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Pension Plans," National Institute on Retirement Security, Washington, DC.

[2] R. Merton, 2014 (July-Aug.). "The Crisis in Retirement Planning," *Harvard Business Review, pp.43-50.*

[3] D. Oakley and K. Kenneally, 2013 (Feb.), "Pensions and Retirement Security 2013: A Roadmap for Policymakers," National Institute on Retirement Security, Washington, DC.

saying that they had not planned financially for retirement, and 25 percent reporting that they had done no planning at all.[4] Americans want help; 86 percent of Americans believe that that leaders in Washington need to give retirement a higher priority, with 62 percent strongly agreeing.[5]

Unlike those with only individual savings plans, retirees and workers covered by DB pensions can respond to the question that Merton puts forth with a fairly simple and easy to understand answer, based on their pension plan's benefit formula. For example, assuming that they worked with their employer for 30 years with a benefit formula providing 1.5% percent of final average salary in a traditional DB pension, then the workers can figure on being able to replace 45 percent of their pre-retirement income. Together with Social Security's level of income replacement as published by the Trustees, a worker covered by that DB pension has a good base to achieve the "comfortable" retirement target they hope to reach.

I. DB Plans Provide Predictable Retirement Security to Middle Income Older Americans

The predictable monthly benefits provided by DB plans remain a source of security to these retired households, enabling millions of Americans to remain secure and independent in old age. Shortly after ERISA became law, benefit payments from private sector DB pensions totaled \$15.2 billion, while plan assets amounted to \$231 billion.[6] In 2012, private sector DB pension plans paid out some \$175.6 billion in pension benefits to 12.7 million retired Americans and other beneficiaries.[7] These DB pension plans had plan assets of \$3.0 trillion at year-end 2012.[8]

NIRS research, *The Pension Factor 2012,* finds that DB pension income continues to play a vital role in reducing the risk of poverty and material hardships among older Americans. Using U.S. Census Bureau's Survey of Income Program Participation (SIPP) panels, we calculated that rates of poverty among older households without DB pension income were approximately nine times greater than the rates among older households with DB pension income in 2010. When we did the same study before the Great Recession in 2006, we found the rate of keeping households out of poverty just six times greater. Additionally, DB pension recipient households were less reliant on means-tested cash and non- cash public assistance. DB pensions appear to have particularly improved the economic security of more vulnerable subpopulations of elder households,

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[4] Board of Governors of Federal Reserve System, 2014(June), "Report on the Economic Well-Being of U.S. Households in 2013," Board of Governors, Washington, DC.

[5] D. Oakley and K. Kenneally, 2013 (Feb.).

[6] P. Seburn, 1991, "Evolution of employer–provided defined benefit pensions," Monthly Labor Review, U.S. Bureau of Labor Statistics (BLS), Washington, DC.

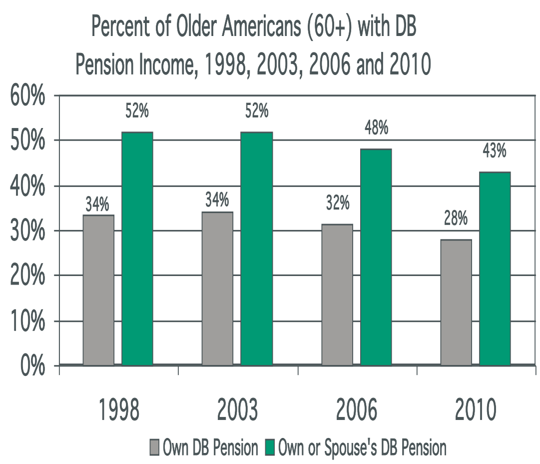
[7] U.S. Census Bureau and BLS, 2013, Current Population Survey Annual Social and Economic Supplement, "Source of Income in 2012-Number with Income and Mean Income of Specified Type in 2009 of People 15 Years Old and Over by Age, Race, and Hispanic Origin, and Sex," BLS, Washington, DC.

[8] Board of Governors of Federal Reserve System, 2014(June 5), "Z.1: Financial Accounts of the United States Floe of Funds, Balance Sheets, and Integrated Macroeconomic Accounts, First Quarter 2014," Board of Governors, Washington, DC, Table L.116.

diminishing common gender and racial disparities in rates of poverty, and dependence on public assistance.[9]

Moreover, NIRS estimates that in 2010, DB pension receipts among older American households was associated with 4.7 million fewer poor and near-poor households, which translated into 1.22 million fewer households receiving means-tested public assistance. In terms important to governments, that means spending about $7.9 billion dollars less on public assistance to older households because of DB pension income.[10]

Unfortunately, *The Pension Factor 2012* also revealed a declining rate of DB pension income receipt among older households. In 1998, more than half (52%) of older Americans had income from a DB pension from either their own or their spouses' pensions. By 2010, the percent of older Americans having income from either their own or from spouses' DB pensions fell to 43 percent.[11] The level of DB pension receipt falls significantly if only the DB pension from the retiree's retirement plan is considered, indicating the benefit of the change that Congress made to ERISA with the passage of the Retirement Equity Act, which clarified spouses right in pension benefits. DB pension income is especially important to middle income older Americans, as 55 percent of older households in both the 3rd and 4th household income quintiles had income from a DB pension in 2010.[12]



Source: Porell and Oakley, "The Pension Factor 2012"

According to data from the U.S. Bureau of Labor Statistics, which began keeping data on the level of DB pension converge among large and small private sector employers in 1990, 35 percent of all private sector employees were covered by DB pension in the early 1990s but such coverage stood at 18 percent in 2011.[13] With decades of declining DB plan participation rates

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[9] F. Porell and D. Oakley, 2012 (Jul.), "The Pension Factor 2012: The Role of Defined Benefit Pensions in Reducing Elder Economic Hardships," National Institute on Retirement Security, Washington, DC.

[10] Porell and Oakley, 2012.

[11] Porell and Oakley, 2012.

[12] Porell and Oakley, 2012.

[13] W. Wiatrowski, 2012, "The last private industry pension plans: a visual essay," Monthly Labor Review, Washington, DC, BLS.

among active employees, we can anticipate further increases in the numbers of older American workers entering retirement without the security of a pension in the years ahead.

II. Role of DB Plans in Retirement Readiness of Near Retirees and Other Workers

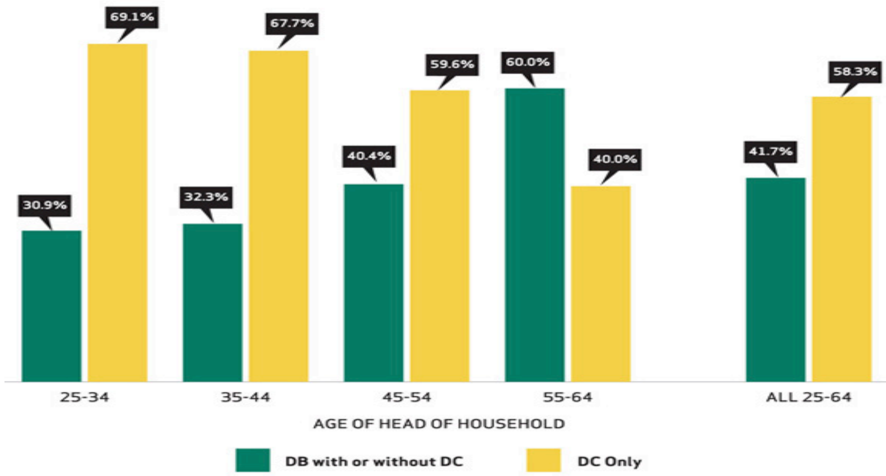
Employer-sponsored retirement plans remain the most important vehicle for ultimately providing retirement income among working households after Social Security. However, a large share of American workers lacks access to a retirement plan through their employer.

Historical retirement participation data indicate that gradual changes over past decades resulted in participation in retirement plans peaking around the year 2000 and then declining over the last decade. According to Current Populations Survey (CPS) data, by 2012, only 52 percent of private sector employees age 25-64 had access to a retirement plan on the job—the lowest rate since 1979.[14] The Survey of Consumer Finances (SCF) illustrates a similar trend on a household level. The share of working families in which neither the head of household nor the spouse participated in a retirement plan through their job increased from 42.7 percent in 2001 up to 48.7 percent in 2013.[15]

Those workers who do participate in a retirement plan will be much more likely to rely on assets from individual retirement accounts in a 401(k) or other defined contribution (DC) plan rather than on a predictable monthly income from a DB pension. Given that older households with DB pension income generally fared better during the recent economic turmoil relative to households without such income, this trend may have an impact on future workers retirement security, especially middle-income American households.[16]

DB and DC plan participation among households covered by an employer-sponsored retirement plan, by age of head of household, 2010

[14] N. Rhee, 2013 (June), "The Retirement Savings Crisis: Is It Worse Than We Think?," National Institute on Retirement Security, Washington, DC.
[15] NIRS analysis of microdata from Board of Governors Federal Reserve System, 2013 Survey of Consumer Finances, Board of Governors, Washington, DC.
[16] Porell and Oakley, 2012.



Source: Rhee, 2013 "The Retirement Crisis: Is It Worse than We Think? Households with negative earnings excluded.

Among working-age households in which the head or spouse participated in an employer sponsored retirement plan through a current job, the share that had a DB pension—whether alone or with a DC account—dropped precipitously from 73 percent in 1989 to 42 percent in 2010 with much of that decline occurring prior to 2001. Households currently near retirement represent the last generation of workers to enjoy widespread DB pension coverage. Among households covered by workplace retirement benefits, the chart above illustrates that while 60 percent of older households (age 55-64) are covered by a DB pension, younger households are half as likely to have a DB pension—31 percent for age 25-34 and 32 percent for age 35-44.[17]

Using the 2010 SCF data, James M. Poterba notes a "virtual absence of financial wealth and DB pension wealth for roughly half of the 'young elderly' household. He also breaks down the sources of dedicated retirement assets held by the 73.6 percent of households ages 55-64 in 2012 that had either a DC account, an IRA or a DB pension. He finds a pattern of heterogeneity in his tabulations of ownership of and median balances in retirement savings vehicles. While 37.4 percent have just one retirement plan, 26.3 have two types of plans and 10 percent have all three types of plans a DC, IRA and DB.[18]

[17] N. Rhee, 2013 (June).

[18] J.M. Poterba, 2014. "Retirement Security in an Aging Society" Working Paper 19930, National Bureau of Economic Research, Washington, DC.

Source: Authors calculation from Poterba, "Retirement Security in an Aging Society" Table 13.

The figure above uses his analysis to illustrate the ownership and value of accounts that will likely be sources of income for near retirees. In each of the three ownership categories, the value of the median balance of the DB pension is the most significant retirement asset. Poterba indicates that not all of the differences are income related, as wide variations in propensities to save exist across the income distribution.[19]

The shift away from DB pensions will leave most covered workers needing to rely only on assets accumulated in DC accounts to supplement their Social Security income. This trend has had profound consequences for American workers and families in terms of the risks and costs they now bear in saving and investing to fund their own retirement. Unfortunately, the typical household—even one near retirement—has only a few thousand dollars in retirement account assets, nowhere near the $100,000-plus median account for those who actually have such retirement savings.[20]

III. Income Certainty Helping Older Americans Also Helps Steady the Economy

Reliable pension income can be especially important not only in providing retirees with peace of mind, but also for stabilizing local economies during economic downturns. Retirees with DB pensions know they will receive a predictable income even during tough economic conditions. And can maintain their spending levels during such downturns. In contrast, retirees without DB pensions may be reluctant to spend out of their 401(k)-type accounts if their savings are negatively impacted by a sizeable market downturn.

[19] J.M. Poterba, 2014.
[20] N. Rhee, 2013 (June).

The Social Security system had been demonstrated to stabilize the economy because it provides steady support for consumer demand.[21] To the extent that DB pensions provide retirees with steady income available for spending regardless of fluctuations in the stock market, DB pensions may play a stabilizing role in the economy similar to Social Security.

NIRS analysis indicates that DB pension benefits not only provide a secure source of income for many retired Americans, they also contribute substantially to the national economy. The economic gains attributable to DB pension expenditures are considerable. NIRS finds that, in 2012, over $175 billion was paid out in pension benefits from private sector DB pension plans to 12.7 million retired Americans who were beneficiaries of these plans.[22]

The expenditures made from those payments to beneficiaries of private sector DB pensions collectively supported:

- 2.3 million American jobs that paid over $138 billion in labor income;
- $347 billion in total economic output nationwide;
- $204 billion in value added (GDP);
- $50 billion in federal, state, and local tax revenue.[23]

DB pensions play a vital role in sustaining consumer demand that, in turn, ultimately supports millions of jobs, and hundreds of billions of dollars in income, output, value added, and tax revenues. The pension expenditure multiplier for the United States was $1.98. Simply that means that for every dollar that private sector defined benefits paid to a retired American from a private sector DB pension in 2012 year the economy generated a $1.98 of total output in the national economy. [24]

For example, Howell's Grocery and Restaurant is one of the oldest businesses in Stuart Virginia, a town with more than half of its population of 1,400 over age 50. Leon Howell's family has owned the business since 1924. The restaurant is a favorite of locals for a good meal. Howell has about a dozen employees. Leon says, "I'm glad we have retirees and others spending at Howell's so we can provide jobs for hardworking folks.[25]

In supplying a stable source of income to retirees, DB pension plans support the national economy, as well as local economies throughout the country, with jobs, incomes, and tax revenue. Pension benefits play an important role in providing a stable, reliable source of income regardless of economic climate—not just for retired Americans, but also for the local economies in which their retirement checks are spent.

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[21] T. Ghilarducci, J. Saad-Lessler, and E. Fisher, "The macroeconomic stabilisation effects of Social Security and 401(k) plans," Cambridge Journal of Economics, pp. 237-251.

[22] N. Rhee, 2014, "Pensionomics 2014: Measuring the Economic Impact of State & Local Pension Plans," National Institute on Retirement Security, Washington, DC.

[23] N. Rhee, 2014.

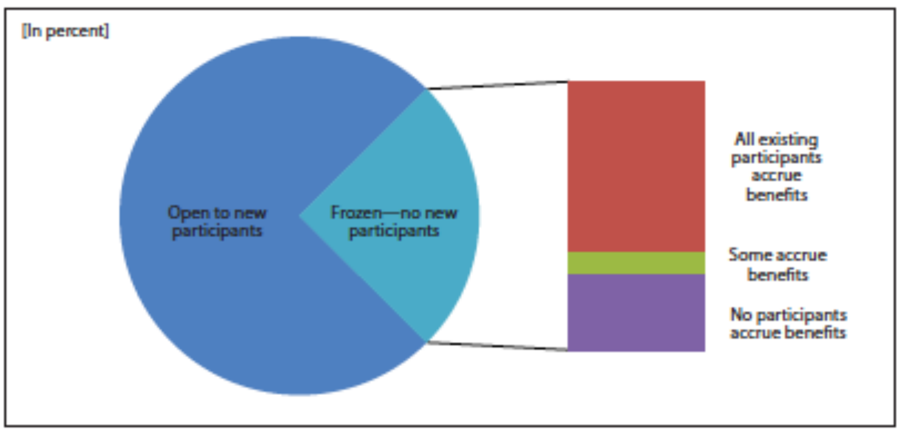
[24] N. Rhee, 2014.

[25] N. Rhee, 2014.

IV. Greater Uncertainty Pushes a Transition in Private Employer-Provided Pensions

Large firms generally offer more generous benefits, and a small but significant number continue to sponsor DB pensions.[26] However, small businesses—which account for approximately two-thirds of workers that lack access to a retirement plan—often find it too expensive and complicated to set up such a plan. BLS indicates that 10% of all private employers offered DB pensions covering 18% of workforce in 2011.[27] This shift has been fueled in part by changes in the nature of the private sector workforce, as well as accounting and government regulations that created more volatility and less predictable balance sheet representations of financial risk and funding cost. McFarland indicates that the switch to DC plans becoming the primary retirement vehicle carries other risk for employers "such as counter-cyclical workforce trends that may necessitate increased severance pay, raise benefit costs and result in less mobility within an organization." [28]

Percentage of defined benefit pension plan participants in open and frozen plans, private industry, 2011



Source: BLS, 2012

Among private industry offering DB pensions, workers have experienced a trend toward frozen plans, most often for new employees, with some plans also stopping the accrual of benefits for current employees. BLS is the source for the above figure that reflects that 1 in 4 participants in a DB pension is in a frozen plan but two-thirds of current employees covered by a frozen plan continue to accrue benefits.[29]

By year-end 2013, only 24 percent of Fortune 500 companies continued to offer DB plans, down from 60 percent in 1998 according to Towers Watson. While they also found that certain industries as well as employers with well-funded pensions continue to offer the plans to new

[26] Towers Watson, 2011 (Nov.), "Pension Freezes Among the Fortune 1000 in 2011," *Insider*, Towers Watson, Washington, DC.
[27] Wiatrowski, W. 2012.
[28] B. McFarland, 2014(Sept.), "Retirement in Transition for the Fortune 500: 1998-2013," *Insider*, Towers Watson, Washington, DC.
[29] Wiatrowski, W. 2012.

hires. Since 1998, 21 percent of the 2013 Fortune 500 employers have frozen their DB pensions, 15 percent have closed the DB pension to new employees and 2 percent have terminated their DB pension using annuities or lump sum payments. These employers have transitioned workers to DC plan coverage using various paths. Meanwhile, 38 percent of these very large employers maintained only DC plans through the period.[30] It should be noted that this trend has slowed with just 5 Fortune 500 companies moving from DB to DC plans for new hires in 2013 as compared to 50 such companies during 2007 to 2009.[31]

Because DB pensions are designed to provide employees the ability to maintain a predictable and reasonable standard of living into retirement, these plans encourage workers to remain with their employer as well as provide for orderly workforce management for the employer. Recent studies by Prudential and Mercer find that employers with DC plans and other accumulation type plans are now finding that older employees are not retiring causing "choke points" in talent pipelines that lead to increased turnover among younger workers.[32]

Research has found that this DB pension retention effect spans all ages, with 58 percent of employees under age 40, 68 percent of employees aged 40 to 49 and 76 percent of employees 50 and older reporting that their DB pension is an important reason they will stay with their employer.[33] Employee engagement and commitment to the employer have been somewhat eroded by the freezing of DB pensions as 45 percent of workers covered by DB pensions are concerned that their employer will reduce the value of their DB plan and 37 percent are concerned that the employer will close the DB plan.[34]

Conclusion

A researcher who looked at the evolution of DB pensions in 1991 made this observation:

> Changes in private sector pension plans that have occurred since 1875 have, in almost all cases, benefited workers. Changes have resulted from employer's initiatives, collective bargaining, and pension legislation."[35]

Significant retirement security challenges face baby boomers and the upcoming generations of working families. With many employees seeing the disappearance of secure retirement income from DB pensions and the trend since 2000 in declining workplace retirement plan coverage overall, Americans face a retirement savings burden that is heavier than ever. This shift places significant responsibility on individuals to plan for their own retirement, but a recent survey by the Federal Reserve, noted earlier, found that only one-fourth of us are doing so. Most

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[30] B. McFarland, 2014 (Sept.).

[31] B. McFarland, 2014 (Sept.).

[32] L. Weber, 2014 (June 17), "The Hidden Downside to 401(k) Plans" The Wall Street Journal, New York, NY: Plan Sponsor, 2011, "Meeting the Challenge of Building Better Outcomes" Plan Sponsor,

[33] J. Gardner, and S. Nyce, 2014(Aug.), "The Strategic Value of Retirement Benefits: A Global Focus" *Insider*, Towers Watson.

[34] J. Gardner, and S. Nyce, 2014(Aug.).

[35] P. Seburn, 1991, p. 22.

Americans report giving none, little or just some thought to planning for retirement and the top plan is to keep on working and rely on Social Security.[36]

Looking back in another 20, 30 or 40 years, will there be a researcher who will examine the changes since ERISA and be able to make the claim that almost all of the pension law changes benefited workers? That answer is uncertain and a sustained increase in retirement savings is needed to put all Americans on a path toward financial security. Indeed, after 40 years of ERISA, I fear we really haven't moved any further toward making sure every American can retire. I hope that this will not be the case 40 years from now.

Given the low level of readiness for retirement, strengthening the Social Security safety net, expanding access to low-cost, high quality retirement plans such as the Administration's recently-announced myRA proposal and other proposals designed to expand workplace retirement coverage both at state and federal levels, and expanding incentives like the Saver's credit that already helps over 6 million low-income families save for retirement are important policy considerations.

I am happy to respond to your questions on DB pensions and retirement income security.

[36] Board of Governors, 2014(June).